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Worries Over Yen's Rapid Rise

The rapid rise of the yen against the dollar has aroused concern in Tokyo and at the Federal Reserve Board in Washington. A 6.2 percent jump in just six days of trading took the yen to Y178.8=$1.00 on February 19, its highest closing level since October 1978. Currency traders attributed the dollar's plunge below the Y180 level to U.S. Treasury Secretary James Baker's February 18 statement that the administration "would not be displeased to see a further orderly, gradual decline in the dollar."

The yen's rise was stemmed by comments by Japanese financial authorities, whose words have carried great weight in exchange markets during the past several months. A number of government officials have hinted at the possibility of intervention to stabilize the yen. On February 20 Bank of Japan governor Satoshi Sumita warned against too sharp an appreciation and expressed hope that

more, Tokyo acted despite the opinion of many domestic and foreign analysts that Japanese firms can live with the Y180 exchange rate.

On a broader front, the government has been galvanized into action to stimulate domestic demand. In addition to recommendations from a private panel calling for an increase in wages and reduced savings incentives (see JEI Report No. 7B, February 21, 1986), the economic ministers are supporting changes in Japan's tax structure, an easing of monetary policy and increased government spending to offset the effects of the yen's rise. Although the Economic Planning Agency sees a healthy increase in consumer spending -- the major component of domestic demand -- this year, it expects activity in the manufacturing sector to slow, both in terms of current production and capital investment. If the economy does indeed lose steam, efforts to overhaul the nation's tax and regulatory structures may receive a big boost. At the very least, Japanese policymakers are in for a very busy year.

Jon Choy

Europeans Tune Down The Volume On Relations With Japan

The European Community has decided against hardening its position on overall trade relations with Japan despite a record bilateral 1985 trade deficit of just over $11 billion (see Table). At the same time, however, the Europeans agreed to continue to press Japan for specific changes in trade policy.

Japan's Trade With the European Community, 1984-85

(in millions of dollars)

	1984			1985		
	Exports	Imports	Balance*	Exports	Imports	Balance*
European Community	$19,405	$9,334	$10,071	$20,013	$8,887	$11,126
Great Britain	4,675	2,267	2,408	4,722	4,816	2,905
France	1,935	1,236	699	2,083	1,323	760
West Germany	6,622	2,684	3,937	6,937	2,924	4,014
Italy	1,032	1,049	-17	1,116	1,050	67

*Figures may not total due to rounding.

Source: Ministry of Finance

On February 6 the EC Commission submitted a set of proposals to the Council of Foreign Ministers calling for the following actions: negotiations on specific items; increased cooperation to encourage EC exports to Japan and Japanese investment in the continent; and the creation of an *ad hoc* committee to monitor items of concern and facilitate consultations. In addition, the package reiterates other familiar themes, including the setting of import targets by Japan and easier access to Japan's financial markets for European organizations.

At the urging of a group of businessmen two days earlier, the EC had called on Japan to lower domestic taxes and tariffs on alcoholic beverages. Criticizing the Japanese system as arbitrary, the EC called for a uniform tax and tariff system based on alcohol content -- the internationally accepted practice. The current Japanese system uses a more subjective three-class system to apply widely varying rates to imported and domestic drinks. European distillers and brewers claim that Japanese taxes on their exports were twice as high as European levies on similar Japanese products over the last two years. Further, Japanese import tariffs, they protest, are 170 percent to 620 percent higher than comparable European levies.

Capping these discussions, the 12 EC foreign ministers met February 17 and 18 to debate a report on trade policy toward Japan. While adopting the EC Commission's recommendations, the report extended an olive branch to Tokyo in the form of praise for Japan's efforts to move away from an export-dependent economic structure. Nevertheless, the EC is still waving a big stick at Japan by pursuing its claim at the General Agreement on Tariffs and Trade that Japan's low level of imported manufactured goods violates GATT principles. Even here, however, the EC is leaving the door open for individual members to take independent positions.

The foreign ministers were particularly interested in two of the commission's suggestions. Increased monitoring of Tokyo's progress toward implementing its July 1985 market liberalization program will be instituted and related programs aimed at trade in specific goods -- video cassette recorders and digital audio discs, for example -- will also be strengthened. The proposal to begin negotiations on improving access to Japan's market for specific European goods was also heartily endorsed. The EC undoubtedly hopes to duplicate the successful market-oriented, sector-selective (MOSS) talks between Japan and the United States.

The observation that ideology is not a factor when it comes to trade is supported by recent calls on Japan to reduce its trade surplus with Eastern European countries. The Comecon nations have had no more success in penetrating Japan's markets than their Common Market counterparts. Although Japan's surplus with Eastern Europe is a small fraction of Western Europe's ($247 million as opposed to $13 billion in 1985), even small imbalances can pose severe problems for foreign-currency-strapped communist countries. Japanese representatives have responded to earlier calls for action by citing the poor quality of steel and other products from Eastern Europe as the primary reason for the imbalance. Changing their tactics, the delegates to a Warsaw Pact trade conference expressed interest in promoting Japanese investment in basic industries (as opposed to high technology) and in obtaining Japan's help with sales of their merchandise in the third world, particularly Asia and Africa. Tokyo has yet to respond to these overtures.

Despite the persistent calls for action, Tokyo remains confident that things can be worked out. Unlike the United States, the European nations are not threatening Japan with strong protectionist actions. Trade expansion appears to be Europe's goal. Such an approach makes better economic sense, but may not reduce bilateral imbalances for many years.

Jon Choy

assistance for small and medium-sized firms (see article in this issue). This move may indicate that Japan is unwilling to make sacrifices in order to help correct the trade imbalance, he said.

• The U.S. Negotiating Stance - Despite the administration's "get tough" position, several legislators attempted to pin the USTR down on specific concessions wrought from Tokyo since September. Mr. Jenkins challenged the USTR to tell him what benefits the U.S. footwear industry gained from the resolution of the Section 301 investigation on leather and leather products, forcing Mr. Yeutter to acknowledge that the U.S. negotiating team got less market access for U.S. industry than it wanted (see JEI Report No. 1B, January 10, 1986). Maintaining that "we moved them as far as we could," Mr. Yeutter added that overall, the result of the talks on leather and leather products can be considered "very satisfactory" since it provided market concessions in other product areas, including aluminum.

Noting the fine line between tough negotiating and protectionism, Rep. Richard Gephardt (D, Mo.) said he was unconvinced that the administration was using the threat of closed U.S. markets as leverage to "change the behavior" of recalcitrant trading partners. Mr. Yeutter agreed on the need to help change national attitudes, saying "We [in the administration] have all pointed out that Japan must play a leadership role in world trade," but added that he was more than willing to use any kind of leverage provided by Congress or the executive branch. "My feeling is," said Mr. Yeutter, "that we need to pursue the Japanese on every front."

Sheri Hoptman

A Deluge Of Red Ink: The 1985 U.S. Trade Account

The final 1985 U.S. trade figures had all the makings of the lead story on the last day of January's newspapers and television news programs. Yet if the story of this country's mind-boggling trade deficit even rated front-page or network coverage, the news appeared below the fold or at the bottom of the broadcast. To business reporters and their editors, it appears, the $148.5 billion red-ink entry for 1985 (imports valued c.i.f.) was old news since that was almost exactly the same number Reagan administration policymakers had been working with since the 1984 trade deficit came in at $123.3 billion.

What journalists consider old news is still fresh political ammunition for congressmen pushing protectionist legislation -- no matter how many economic duds there are among the new bullets. And there are plenty. Exports did slip 2.2 percent last year to $213.2 billion after rallying 8.7 percent in 1984 from a two-year decline, but this drop was surprisingly small considering the impact of the high-flying dollar on the price competitiveness of U.S. suppliers overseas, the generally so-so economic performance turned in by other industrialized nations, the debt problems of many developing countries, and the scaled-back revenues of oil exporters. Likewise, while imports expanded 6 percent in 1985 to $361.6 billion, this gain was modest -- whether compared with the 26.4 percent jump in purchases that occurred two years ago or in terms of the slowdown in U.S. growth -- since the overvalued dollar gave foreign competitors a big edge in the American market.

U.S. Exports to Japan

(in millions of dollars, f.a.s. value basis)

	January-December 1984	January-December 1985	Percent Change
Total Exports	$23,575.0	$22,630.8	-4.0%
Industrial Supplies	9,139.2	8,679.9	-5.0
Bituminous Coal	865.4	769.1	-11.1
Petroleum Products	683.1	762.0	11.6
Natural Gas	262.3	249.1	-5.0
Nuclear Fuels	145.7	121.5	-16.6
Logs and Lumber	840.5	884.9	5.3
Paper Base Stocks	519.9	470.2	-9.6
Paper and Paper Products	290.0	288.9	-0.4
Organic Chemicals	717.1	704.0	-1.8
Inorganic Chemicals	836.4	801.9	-4.1
Plastics and Synthetic Resin Compounds	356.5	305.6	-14.3
Fertilizers and Insecticides	297.7	276.9	-7.0
Steel Scrap	264.9	199.1	-24.8
Nonferrous Ores and Scrap	363.8	459.6	26.3
Nonferrous Metals	378.9	289.4	-23.6
Textiles	112.8	107.5	-4.7
Raw Cotton	605.1	368.0	-39.2
Hides and Skins	325.2	298.2	-8.3
Leaf Tobacco	286.0	302.4	5.7
Capital Goods	5,626.6	5,938.6	5.6
Nonelectric Machinery	3,458.5	3,384.7	-2.1
Data Processing Equipment	1,166.2	1,331.1	14.1
Measuring, Testing and Control Instruments	445.5	448.7	0.7
Laboratory Testing and Control Instruments	93.6	104.5	11.7
Scientific, Professional and Medical Equipment	247.1	265.5	7.5
Power Generating Equipment (excl. aircraft and automotive engines)	307.5	73.3	-76.2
Metalworking Equipment	105.5	113.9	8.0
Service Industry Equipment	111.3	120.1	7.9
Electric Machinery	874.9	804.3	-8.1
Generators and Transformers	92.3	75.9	-17.8
Broadcast and Communications Equipment	416.7	327.1	-21.5
Telephonic and Other Electric Equipment	365.8	401.3	9.7
Transportation Equipment	1,293.2	1,749.6	35.3
Civilian Aircraft	541.4	905.9	67.3
Civilian Aircraft Engines and Parts	437.5	552.1	26.2
Automotive Parts	180.2	214.8	19.2
Food and Feed	5,929.2	5,000.7	-15.7
Corn	1,999.3	1,305.3	-34.7
Sorghum	269.8	242.9	-10.0
Soybeans	1,172.7	937.7	-20.0
Wheat	534.4	469.0	-12.2

Fruits and Vegetables	452.6	452.1	-0.1
Meat and Meat Products	571.0	540.8	-5.3
Fish and Fish Products	502.9	685.4	36.3
Consumer Goods	1,475.5	1,415.5	-4.1
Pharmaceuticals	571.8	590.5	3.3
Toys and Sporting Goods	89.3	79.7	-10.8
Cigarettes	95.4	94.9	-0.5

U.S. Imports from Japan

(in millions of dollars, Customs value basis)

	January-December 1984	January-December 1985	Percent Change
Total Imports	$57,135.0	$68,782.9	20.4%
Automotive Products	18,476.9	24,980.0	35.2
Cars	12,349.9	16,231.3	31.4
Assembled Trucks	2,912.0	4,311.6	48.1
Automotive Parts	3,205.6	3,938.4	22.9
Capital Goods	19,289.6	21,515.7	11.5
Nonelectric Machinery	12,891.9	14,448.9	12.1
Business Machines	6,414.6	6,274.1	-2.2
Metalworking Machinery	896.6	1,238.7	38.2
Specialized Industrial Machinery	1,480.6	1,323.1	-10.6
Scientific, Professional and Medical Equipment	477.1	670.0	40.4
Electric Machinery	6,029.4	6,542.6	8.5
Transportation Equipment	368.3	524.2	42.3
Consumer Goods	11,265.6	14,017.2	24.4
Video and Audio Recorders and Players and Stereo Equipment	3,756.7	5,280.1	40.6
Television Sets	684.3	827.7	21.0
Radio Receivers	285.5	306.9	7.5
Tableware and Glassware	408.8	442.8	8.3
Metal Cookware and Cutlery	403.5	438.3	8.6
Photographic and Optical Goods	1,038.0	918.5	-11.5
Clocks and Watches	437.6	479.9	9.7
Toys and Sporting Goods	412.2	563.8	36.8
Motorcycles and Parts	661.5	883.8	33.6
Clothing	494.0	487.3	-1.4
Intermediate Goods	7,275.6	7,035.3	-3.3
Steel Mill Products	3,149.9	3,048.3	-3.2
Nonferrous Metals	506.4	535.0	5.7
Organic Chemicals	514.7	564.1	9.6
Tires and Tubes	516.3	561.9	8.8
Textiles	671.0	715.2	6.6

However hard, it might be possible to persuade congressional supporters of protectionism that the stratospheric overall U.S. trade deficit does not necessarily constitute prima facie evidence of across-the-board unfair practices by this country's major trading partners. The chances of convincing them of the same thing when it comes to the U.S. imbalance with Japan are more remote, if only because the bilateral deficit bulged from $36.8 billion in 1984 to $49.8 billion last year (imports again valued c.i.f.). Yet if legislators take a close look at the figures, they might find some surprises that could change their perceptions of Japan as an unfair trader.

Sales to Japan did fall 4 percent in 1985 to $22.6 billion after posting back-to-back increases, but this decline largely reflected lower prices for bulk agricultural and industrial inputs. Manufactured products, in contrast, did almost uniformly well although they had to overcome the demand-dampening effects of the high dollar. Jet transports were just the biggest winners on a list that included computers and peripheral equipment, measuring and testing instruments, scientific and professional equipment, telecommunications equipment, aircraft engines and parts, automotive parts and pharmaceuticals.

There is also a thin silver lining to the import numbers. Purchases of Japanese-made products admittedly went up 19.9 percent to $72.4 billion, but this rate was only about half of 1984's. Moreover, two product groups alone provided most of the expansion. One, not surprisingly, was automotive products, particularly cars, which jumped by nearly one-third; the other, also not unexpectedly, was consumer electronics, especially video cassette recorders. Outside of these two areas, however, modest growth or no growth was generally the rule in 1985. In fact, purchases dropped in three of the top import groups -- steel, data processing equipment and other business machines, and specialized industrial machinery.

Susan MacKnight

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The views expressed in this report are those of the authors and do not necessarily represent those of the Japan Economic Institute.